Chapter 20

Toward a Comprehensive Affordable Housing Strategy for Canada

STEVE POMEROY

Finding Room: Options for a Canadian Rental Housing Strategy

Edited by J. David Hulchanski and Michael Shapcott

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This paper presents an overview of the issues underlying the affordable housing problem and sets out a series of options that should be considered as part of a comprehensive national housing strategy.

Defining the Problem – The Nature of Housing Need

The primary basis for social housing policy is the presence of circumstances (housing need) in which individuals or families are not able to meet their shelter needs through their own resources. The appropriate choice of policy instruments depends on the nature of the housing problem being addressed.

Housing need in Canada has been defined in terms of adequacy, suitability, and affordability. These problems are the basis for the definition of housing need established by Canada Mortgage and Housing Corporation, and are used in defining and measuring need by all provinces and territories. This measure is called *core housing need.*

"Core housing need" means (a) that a household is experiencing at least one of the following three housing problems, based on established housing standards and (b) that the household has insufficient income to resolve this problem without assistance.

- *Suitability*: This standard uses national occupancy standards to determine if households have a sufficient number of bedrooms based on the family composition (effectively a measure of crowding).
- *Adequacy*: A standard that measures housing condition to determine if the dwelling is safe, has basic plumbing, and is in a reasonable habitable state of repair.

- *Affordability*: A standard based on a ratio of housing expenditures to total household income; a household paying more than 30 percent of its income for housing is considered in need.

Table 1: Core Housing Need, 1996

Total	**1,725,655**	
Renters	1,172,270	68%
Owners	553,385	32
Unattached individuals	878,415	51%
Single female	245,950	28
Single male	149,330	17
Living with others	52,705	6
Families	847,235	49%
Two parents with children	144,030	17
Couples, no children	110,140	13
Female lone parent	144,030	17
Male lone parent	16,945	2
Multiple family	8,475	1

Source: CMHC; 1996 Census

If a household is below one or more of these standards, a second test is applied to determine if a suitable and adequate dwelling is available in its community for rent within 30 percent of the household's income. This measure uses the median rent of an appropriately sized private rental unit and converts the rent to an annual income required to afford this unit based on spending 30 percent of income for rent.[1] A household with gross income below this level, and living below any of the three housing standards, is defined as being in core housing need.

This formal housing need measure is based on data collected by Statistics Canada. Before 1996, the Household Income, Facilities and Equipment database was used; since 1996, the Survey of Household Spending has been used to collect data, but CMHC has not published updated housing need data since the 1996 census. Thus 1996 census data remain the most recent official basis for housing need statistics, and are used in Table 1 to indicate housing need.

CMHC reports that 1.7 million households or 7.6 percent of the total

were in core housing need in 1996. This figure compares to 1.2 million households or 12.2 percent of the total in 1991.

These core need problems are divided almost evenly between unattached individuals (51 percent) and families (49 percent). Single females make up more than one-quarter (28 percent) of all households in need. Seniors make up just over one-fifth of households in need, distributed between unattached individuals and family couples. Among families, lone parents are the largest category in need.

More than two-thirds of households in need are renters (68 percent), even though renters represent only 35 percent of the population. Renters usually experience an affordability problem; owners in need tend more often to have adequacy problems (e.g., poor condition of dwelling).

Affordability is, by far, the most serious problem: 95 percent of core need among renters relates to affordability. Not surprisingly, low income is a key determinant of core need: 85 percent of households with incomes below $10,000 and 61 percent of those with incomes below $20,000 are in core need.

In the 1990s, heightened awareness about homelessness added a new dimension to these housing need categories – absolute homelessness and households "at risk." Absolute homelessness means living without four walls and a roof, and perhaps more important, without a door that one can lock to create private living space and security. "At risk" is the term for families and individuals who have formal shelter, but whose circumstances are precarious. They are deemed at risk of homelessness for one of several reasons – the cost of shelter consumes such a large part of their income that they are vulnerable to rent arrears and eviction; they are temporarily living with a friend or relative but have no permanent place of residence; they are personally at risk of physical or mental abuse; or they have disabilities that may cause them to lose their shelter.

One measure used to help determine the number of households at risk is a very high shelter cost burden – paying more than 50 percent of income for shelter. In the United States, the 50 percent benchmark is used to indicate "worst case need" or "severely burdened households." These terms have not been used in Canada, but the 1996 census identified 830,000 renters above this benchmark – 22 percent of all renters.

Understanding the affordability problem

Affordability problems are created by a combination of low incomes and relatively high rents. The 1990s were characterized by stagnant incomes,

especially among renters. Between 1991 and 1996, the average real income of renters declined by 12.4 percent.[2] Although incomes grew after 1996, most renters did not share in the gains. As higher-income renters exercised the option of moving into ownership, the renter profile came to be dominated by the remaining lower-income households.

Table 2: Social Assistance Families as Percentage of All Families in Core Housing Need

	Family %	Lone Parent %	Non-family %	Total Non-senior %
Atlantic	65	87	55	68
Quebec	64	80	68	70
Ontario	46	75	42	52
Prairie	40	54	39	44
B.C.	37	65	27	38
Canada	49	74	49	56

Source: Statistics Canada, HIFE 1996 data file.

Estimates suggest that more than half of core need households are recipients of social assistance. The percentage varies by household type and region, reflecting variations in the level of welfare benefits. Analysts now use a shelter-cost-to-income ratio of 50 percent as an indicator of severe affordability problems. As the shelter component of social assistance often makes up as much as 50 percent of the total welfare payments, social assistance caseloads affect the number of households with serious affordability problems.

Between 1990 and 1995, the number of households in core housing need increased by 47 percent and the number of households paying more than 50 percent of income for rent grew by 43 percent. During the same period, there was a marked increase in welfare caseloads, associated in part with the 1990 recession and slow recovery. Since 1995, welfare cases have followed a steady decline, in part due to reduced benefits in some provinces, more restrictive eligibility (especially for single people and youth), and the improving economy.

Data from the Statistics Canada 1998 Survey of Household Spending indicate that the number of renter households paying more than 50 percent of income for rent fell from 830,000 in 1995 to 464,000 households

in 1998. At the same time, the number of renters paying between 30 and 50 percent of income on shelter increased by 250,000 households – suggesting that while incomes may have improved marginally, many households are still paying well over 30 percent for shelter and continue to experience affordability problems.[3]

Shifting factors underlying affordability problems

Between 1991 and 1995 real rents declined, although marginally (-2.5 percent), so the primary cause of increased affordability problems was weak income. Since 1996, increasing rents have become the more important factor – rising by as much as 25 percent between 1996 and 2000 in some centres. This percentage varies across the country, with the largest increases evident in Alberta, Saskatchewan, and Ontario. Rents in Alberta jumped more than 20 percent in only three years, while those in Ontario grew by more than 10 percent.

While rising rents in Ontario have been identified as a consequence of removing rent controls, the more important factor in all provinces has been the persisting low levels of new supply and the consequent decline in rental vacancy rates. As the supply of available units fails to keep pace with population and household growth, rents rise. This problem is especially acute in the lower end of the rental sector, where low-income households seek accommodation.

Low levels of new construction

Most housing in Canada is produced and operated in the private market. The social housing stock – units built and operated by public agencies, non-profit corporations, and cooperatives under various social housing programs – accounts for roughly 700,000 dwelling units in a total stock of just over 10 million dwelling units. Rental housing accounts for just under 4 million units, so social housing constitutes less than one-fifth (18 percent) of the rental housing stock.

Some social housing units are in mixed-income projects and provided at market rent, although most have subsidized rents. The 1996 census reported 1.6 million units renting below $500 a month (affordable at 30 percent of income for households with income of $20,000). So social housing makes up about one-third of the existing affordable stock. By comparison, two-thirds of affordable units are in the private rental sector and include older apartments and apartment suites in homes.

These statistics reveal the important role played by the private sector in contributing to a stock of housing that, over time, has remained or become affordable. But the stock in this sector is also susceptible to erosion. As rents rise with inflation, the number of private units renting below affordable benchmarks declines. In other cases, units may be demolished or the property is converted to condominium ownership.

Between 1991 and 1996, the number of renter households in Canada increased by 180,000. This growth was not matched by new production. In the same period, only 111,000 new rental units were constructed, just over half of them (54 percent) built as social housing. The rest, produced for the private sector, were typically at higher rents, well above affordable levels. The shortfall in new production (roughly 70,000 units) was taken up by vacancies in the existing stock.

Following a building boom in the late 1980s, the level of private rental development slowed in the early 1990s, and privately initiated development has continued to fall. New private rental housing construction fell from an average of well over 30,000 units a year in the 1980s to only 13,000 between 1990 and 1995 and subsequently to only 6,000 annually from 1995 to 1999.

In the mid 1990s, new social housing programs were almost entirely eliminated.[4] As a result, the decline in private rental construction was exacerbated by the cessation of social housing construction (except a little in B.C. and Quebec).

Lack of new rental construction worsens problem of affordability

This decline in new supply – both private and social – has largely driven the affordable housing crisis. Although low rental vacancy rates and increasing rents are a prerequisite to new rental investment, developers and investors have shown limited interest in new construction. Risks to investors and developers remain high while the rate of return on investment is poor and uncompetitive.[5]

Low supply and continuing demand have inevitably applied pressure to rents, exacerbating the affordability problem. At the lower end of the market, there are far more households seeking lower priced units than there are units.

Constrained access to affordable units

The problem is not solely an issue of absolute shortage of modest rent units. A related concern is limited access for lower-income renters.

As a rational entrepreneur, a landlord seeking to rent out a vacant unit typically will try to minimize risk – he or she will prefer tenants perceived to have greater capability of paying the rent. Inevitably, lower-income households will face a greater challenge in securing housing – especially if due to their inability to pay high rents, they previously have been evicted or are in arrears and do not have a sound reference.

In a tight rental market, tenants with good jobs will be preferred. While there is a fine line between prudent landlord behaviour and discrimination, the result is constrained access for low-income tenants, especially social assistance recipients and lone parents with children.

Erosion of the existing affordable housing stock

This situation is worsened by a process of ongoing erosion of the existing privately owned affordable stock. Between 1991 and 1996, the number of rental units renting below $500 declined by 310,000 (roughly 10 percent of the total rental stock). At a time when new rental construction was falling toward an all-time low level, the erosion of lower-priced stock is perhaps the most serious issue facing the affordable housing sector.

Responding to the Need – Possible Policy Options

The goal of social housing policy is to help low- and moderate-income households obtain adequate and suitable housing at a price they can reasonably afford. Three general approaches are possible:

1. Reducing the construction cost of housing so that the rent charged can be lower ("supply measures"), including direct public or non-profit production, measures to lower the costs of production, and incentives for private production with conditions on the level of rents.
2. Increasing a household's ability to pay by increasing or supplementing its income. These "demand-side measures" affect the household's effective demand. Such measures include rent supplements or allowances and income assistance.
3. Influencing the price of existing rental housing, including controlling rent levels to protect affordability, diverting demand (e.g., by helping households buy a home), and encouraging transfers in ownership from private for-profit owners to not-for-profit owners. These approaches are not discussed in detail, except where they relate to the two main categories.[6]

In the next two sections, the following measures are explained and the advantages and disadvantages of each are reviewed. The final section looks at integrating these measures into a comprehensive strategy.

1. Supply measures:
   - Direct support for public/non-profit production;
   - Incentives for private rental unit development;
   - Creating a level playing field for rental development;
   - Reducing development costs;
   - Encouraging lower-cost forms of development – single-room occupancy, secondary suites;
   - Shifting patterns of ownership (toward non-profit ownership).
2. Demand measures:
   - Rent supplement;
   - Shelter allowance;
   - Reform of social assistance shelter benefits.

The measures in each set are not mutually exclusive. In many cases, supply and demand measures complement each other.

Supply Measures

Supporting public/non-profit production

Direct public supply of housing has been the predominant program response in Canada through the postwar period. Although various program designs have been employed, the essential elements of this approach include:

- A public or not-for-profit owner/operator with a specific mandate to operate housing for low-income households.[7]
- Some form of subsidy, either as a capital grant, favourable mortgage rate, or ongoing subsidy, so that the rents charged to tenants are affordable. Generally, the project is governed by an operating agreement specifying the obligations of the operator and requiring the provider to continue serving lower-income eligible households.
- Typically, operating agreements and any ongoing subsidy that match the amortization period of the mortgage. Once the mortgage is paid off, the project rents are required only to cover operating costs and it is assumed that even at low rents, the operator will be able to continue serving lower-income households (in very poor, 100-percent-targeted projects, this may not be feasible without some renewal of subsidy).

- In most non-profit approaches, "affordable rents" established on a rent-geared-to-income ("RGI") basis. Although earlier programs used a 25 percent ratio, most currently employ a ratio of 30 percent of gross income.
- Assisted projects that are fully targeted – meaning that 100 percent of tenants have lower incomes and pay rent on a RGI basis – or mixed income (some units are rented at market rent levels). A mixed-income approach is generally preferable, as it avoids the concentration of very poor households characteristic of earlier public housing.

Advantages

Non-profit production helps create a permanent stock of units specifically to serve lower-income households – a long-term investment in a permanent asset. This form of ownership also provides some assurance that rents will remain affordable over the long term.

Even after operating agreements and subsidies cease, the public investment remains in place, as the non-profit charter restricts ongoing use to providing affordable housing and most non-profit providers retain this initial motive.

Non-profit programs address both supply and affordability issues, which is why they appear to be quite costly compared to alternatives that address either supply or affordability only. It is possible, however, to separate supply and affordability objectives. One such approach involves using a non-profit organization to develop housing at market rent level, then using rent supplement assistance as a separate mechanism to address affordability. Another variant is to help non-profit housing corporations buy existing privately owned rental properties. This approach does not add to new supply, but does preserve long-term affordability and helps check the ongoing erosion of more affordable existing private rental stock.

Supply programs respond directly to low levels of production and, in so doing, moderate the inflationary impact of low supply.

Through the development process, units can be designed specifically to meet particular needs. New supply funding can be geographically targeted to markets with acute supply problems.

Weaknesses

New construction costs and the associated subsidy costs tend to be quite high per unit. Most recent versions of non-profit housing involve

long-term (35-year) subsidy commitments. As new commitments are added in each year, the subsidy cost mounts exponentially. This problem raises the concerns of finance officials and makes these programs a vulnerable target in times of fiscal restraint.

The alternative is to "front-end" the cost with a capital grant. However, this option tends to be expensive because of the high cost of new development compared with relatively low revenues at RGI rents (the latter limit capacity to cover operating and mortgage payments).

Income mixing improves the viability of the projects and lowers the average capital grant requirement, but increases the grant cost per RGI household assisted.

Relative to the volume of housing need, new supply programs can help only a very small number of households in need (at their peak, non-profit programs produced only 25,000 to 30,000 units annually).

Incentives for private rental development

In building new rental housing, a developer is faced with a range of costs and, in return, creates an asset that generates a cash flow in the form of rents. The value of the property to a potential investor is determined not by its cost, but by the level of revenue it can generate. The market value of the new property is based on the value of future income flows.

In the same way that an investor in government bonds is prepared to pay a price for a bond based on an expected rate of return, the rental investor converts future income to a current price based on a similar expectation of an annual return on equity. The main difference is that a government bond is a secure investment, easily traded for cash and the annual interest payments are guaranteed. For the rental investor, the asset is more difficult to trade for cash; it must be listed for sale and await a willing buyer. In addition, the annual cash flow is not guaranteed. The property may have vacancies so no revenues are produced, or be subject to regulations (such as rent controls) that constrain the owner's ability to increase rental income and achieve anticipated cash flows.

Compared to alternatives, rental investment is relatively high risk and thus demands a higher expected rate of return. Currently, rates of return remain far below those expected by potential investors. Costs are too high relative to potential rent revenue, mainly because the costs of production are set outside the rental sector. Ownership housing and condominiums establish land values while construction labour costs and

materials are established in the wider market that includes commercial development.

In the past, stimulus programs have been used to encourage private development. These include programs that provide a grant or interest-free loan to a developer in return for modestly designed units (which should command lower rents than luxury development) and temporary tax measures that provide favourable tax treatment to investors (namely, creating eligible costs that can be used to reduce taxable income).

Effectively, these programs replace some portion of the investor's own equity with government funds without affecting the rental revenue. The investor's rate of return increases to a level that can make development more attractive.

Currently, potential rates of return on modest rental housing have been estimated at less than 5 percent. Increasing a private investor's rate of return to 12 or 15 percent requires capital grants or interest-free deferred loans of at least $15,000 to $20,000 per unit; this amount varies among cities and depends on the type of unit being developed.

Advantages

Any type of new supply can alleviate the pressure of low supply. Even new development at the higher end of the rental market will draw some households out of lower priced stock (a so-called "filtering" or "trickle-down" effect).

Household growth and new demand cover a spectrum of incomes, including higher-income households. Without new development, these households occupy lower-priced units and crowd out lower-income households.

Depending on the development economics in a particular city, stimulus measures leverage private investment and cost less than assisting non-profit development (since, unlike private developers, non-profits typically have little, if any, equity to invest).

Weaknesses

Stimulus measures are controversial. Even the housing industry has argued that this type of intervention disrupts market equilibrium.

The expenditure does not create permanent affordable housing, although it can do so if certain conditions are imposed in exchange for assistance. But when operating agreements enforcing the conditions and

targeting expire, the units are no longer available as affordable housing (the so-called "expiring use problem").

No long-term public asset is created in return for the government investment.

Creating a level playing field for rental development

The poor economics of rental investment are attributable, in part, to the tax treatment of rental housing, which is seen as unfair compared with other investments. Current inequities in the tax system include:

- GST on rental housing. Rental landlords cannot charge GST on rents, yet unlike other goods, rental housing is not zero-rated. So landlords pay GST on supplies and services, but cannot claim input tax credits as they do not collect GST and have no GST remittance against which to claim credits.
- Small rental investors are not considered as "small businesses" and therefore are not eligible for the lower small business tax rate on the first $200,000 of income.
- "Pooling" provisions that once encouraged reinvestment in new rental projects have been eliminated.

Explanation of pooling provisions

When a rental project is sold, investors must pay tax on the difference between the sale price and the depreciated value of the project – i.e., the original cost of the project less the Capital Cost Allowance (CCA) deductions. "Recaptured depreciation" (the difference between the depreciated value of the building – not the land – and the original cost) is taxed at full income tax rates. Capital gains taxes apply to the increase in value above the original cost.

Before 1972, rental investors could defer paying income taxes on recaptured depreciation on buildings sold by "pooling" the recaptured amount with CCA from other buildings. For example, if they acquired another rental project in the same year, they could avoid recaptured depreciation by transferring the excess CCA to reduce the depreciable value of the newly acquired project.

The restoration of pooling (or "roll-over") does not eliminate tax liability. It simply postpones the tax penalty on recaptured depreciation and capital gains for owners of rental properties who invest the proceeds in another rental property. Restoring this provision would create oppor-

tunities for existing investors/owners of fully depreciated properties to leverage their existing assets without facing large tax impacts.

It may be more beneficial from a tax perspective to demolish the property and thereby eliminate the recapture of depreciation. When this happens, existing units, which may be relatively affordable, are lost.

ADVANTAGES

These three measures could correct inefficiencies in tax treatment and, while imposing an expenditure on government, do not constitute a temporary disruptive measure – unlike short-term stimulus measures.

The measures might improve after-tax feasibility of new production (at least for higher-rent properties) and could stimulate new construction with a positive moderating impact on the market, easing rent pressures.

Most tax measures apply only to private developers. However, any reduction in GST also would benefit non-profit providers.

WEAKNESSES

Federal finance officials strongly resist increasing tax expenditures and are reluctant to implement tax changes unless a clear case can be made on equity grounds.

These measures have a direct impact upon the production of affordable housing, but may also stimulate market rent development at higher rent ranges.

Reducing development costs

One of the most critical issues confronting both private and not-for-profit development is the relatively high cost of producing new housing, which is a function of land costs, labour, and material costs. Total development costs also have been increasing as a result of layers of taxes and fees on development.

While costs vary across the country and depend on the type of development, new rental housing in a typical urban centre costs $65,000 to $105,000 for one-bedroom apartments and $90,000 to $160,000 for three-bedroom family units.

Land costs generally account for 15 to 30 percent of the cost. In most markets, land values are established by the condominium market and rental developers are usually unable to compete against condominium

development for land. Land is zoned based on use (e.g., residential) and density (units per hectare or a ratio of the total site area); land cannot be zoned for tenure. Provincial enabling legislation to empower municipalities to offer bonus densities for rental development could help address this situation. Such a provision could increase density for rental (compared to condominium) use so that the net residual value of the land, per unit, would equate to the values created by lower-density condominium development.

Labour and material costs are established in a competitive market place. Currently, a booming construction industry in many parts of the country has resulted in shortages of both labour and materials with an inevitable upward pressure on prices. An affordable housing strategy with a long-term vision might seek to direct assistance on a counter-cyclical basis, supporting development in markets that are in a downturn to take advantage of lower input costs and help offset the costs of an underused labour force (e.g., lower income tax revenues and higher Employment Insurance payments).

Finally, the trend over the past two decades has been toward a pay-as-you-go approach to funding municipal infrastructure related to new development, rather than covering this expense from general property tax revenues spread across all existing development. This practice has resulted in the imposition by municipalities of development cost levies on new construction. The GST added another new cost to development and has carried provincial sales taxes with it in the Atlantic region where federal and provincial consumption taxes are harmonized.

Advantages

Measures to lower land costs for rental housing and development charges can reduce the cost of new development. Several municipalities have waived development fees for certain housing types or in certain areas to encourage residential development in the central core and minimize suburban sprawl.

Reduced fees and charges help to encourage private development and new supply while marginally narrowing the development cost gap faced by non-profit organizations seeking to build.

Weaknesses

Without other complementary measures, these cost-reducing approaches will not lower costs sufficiently to make development feasible

at affordable rents without some subsidy. Even with free municipal land, non-profit development for lower-income households is not feasible without additional subsidy.

Requiring municipalities to lower or remove development costs eliminates municipal revenue and requires the municipalities to shoulder the burden of new development, while the province and federal governments gain income tax revenues from the construction labour and ongoing operations (of for-profit housing).

Encouraging lower-cost forms of development

Another way to address the relatively high cost of new development is to encourage alternative, lower-cost building forms.

Two such options are secondary suites in single detached homes (which are often in contravention of local building regulations) and small unit or "single room occupancy" (SRO) accommodation.

The formal approval and explicit encouragement of secondary suites is a controversial option in many municipalities. Such suites have been created in basements or by subdividing the upper floors of existing homes. Unlike rooming house units, secondary units are typically created in a home in which an owner occupant is also resident, so there is close management of tenants (unlike an absentee landlord). The most bothersome issue from neighbours' perspectives is the lack of on-site parking and the resulting use of limited street parking space. The concern from municipalities is one of health and safety. Often suites are self-built and have not benefited from a permit process that requires inspections to ensure that the units are safe (especially the electrical wiring).

Some municipalities have sought to legalize secondary suites, but few have explicitly promoted this use either through encouraging statements in official plan policies or through small grants to existing owners. A demonstration project under Homegrown Solutions (a federally funded seed grant program administered by the Canadian Housing and Renewal Association) provided funding to the town of Sidney, B.C., for a small homeowner grant of $5,000 to help offset installation costs of an adaptable suite for a person with physical disabilities.

The SRO approach involves the development of very small bed-sitting rooms, usually 150 to 300 square feet (a typical bachelor/studio suite is 350 to 400 square feet). Well-designed small suites can provide cost-effective options for urban singles and have become popular in some U.S. cities. Given that almost half of core need households are low-income single individuals, this building form could respond to demand.

SRO-type development can be cost-effective, since the total floor area per suite is much less than that required for a bachelor or one-bedroom apartment. Few residents can afford to own a car, so parking requirements and costs can be reduced in areas served by public transit – if municipalities agree to this regulatory relaxation. A 1999 study for the Ontario Ministry of Municipal Affairs and Housing found that suites could be developed in large urban centres at a cost of 40 to 50 percent of a typical new one-bedroom unit.

Advantages

Alternative building forms such as secondary suites (apartments within homes) and SRO units have significant cost advantages and can supplement more traditional building forms.

These approaches could stretch any limited subsidy funds further since per-unit costs are lower.

Weaknesses

Regulatory barriers and neighbourhood resistance (the "Not In My Backyard" or NIMBY syndrome) may limit opportunities.

Few proponents are pushing this approach. It is a new concept and therefore even more risky than conventional rental, for which there remains limited investor appetite.

Shifting patterns of ownership and facilitating not-for-profit ownership

Much of the effort of the non-profit housing sector is focused on building new housing. Without subsidies, the costs are prohibitive and, even with subsidies, the subsidy requirements per unit remain significant.

In other sectors, where poverty similarly limits access to necessities, the solution is to seek lower-cost options. Food banks provide food at no cost, and used clothing stores offer clothing at affordable prices. If lower-income households can afford a vehicle, or must have one for transport to work, most lower-income households also drive older used cars. While many households seek housing in the older existing rental stock, the practice of drawing upon older depreciated assets is not frequently used by non-profit providers, even though a large housing stock already exists and properties often are provided for sale – typically at values far below the cost of building new.

This dismissal of property acquisition as an option is, in part, a legacy of former non-profit programs. A number of non-profit housing providers did pursue acquisition and rehabilitation, and typically expended more than the cost of building new, because the properties were in serious disrepair. Few providers tried to find reasonably sound 20- to 30-year-old apartment buildings that needed only minor repairs. Moreover, social housing programs required that all tenants be in core housing need, with incomes below specified thresholds. It was problematic to acquire buildings that were already occupied by some tenants who were not in core need, as this would require evictions. So providers avoided this option.

Many more multiple unit rental properties are sold each year than the number of non-profit units constructed by the programs of the early 1990s. Although not all properties would be appropriate, due to poor condition or high price, many existing properties are regularly transacted (and the number could be increased if rollover provisions of the tax system were revised as discussed under a separate option above). Tax reform would encourage existing owners to sell to non-profit buyers without incurring significant income tax impacts and would provide a source for selective acquisition by non-profits.

Currently, as these properties are offered for sale, new private investors (including institutional investors and Real Estate Investment Trusts) are the purchasers. Typically, new investors upgrade the property to increase the rental cash flow. The alternative – purchase by non-profit organizations – could preserve and potentially expand the remaining stock of housing affordable to lower-income households. With non-profit providers, access by lower-income households would be improved as they would no longer be competing against "better" higher-income tenants.

Any such non-profit acquisition will require some subsidy, ideally a capital grant to facilitate a down payment. But because the total cost per unit typically is much lower than building new (40 percent to 50 percent lower), the grants can be more effectively used and stretched to secure more units.

In lower-cost markets – such as Prairie cities – existing detached homes can be acquired for as little as $20,000 to $30,000. Some communities are exploring options for assembling a portfolio of existing homes as rental properties instead of constructing new buildings.[8]

This acquisition approach can also provide opportunities for lower-income households to become homeowners in time. A critical element

of an assisted ownership program is counselling and ongoing mentoring as well as linkage to employment and human resource training. Despite low house costs, many lower-income households would be unable to qualify for a mortgage, even though the ongoing ownership carrying costs may be less than paying rent on an apartment. With modest assistance – such as non-profit mentoring, a loan guarantee, and a modest down payment grant of up to $7,500 – low-income households could be assisted in obtaining a home of their own with no ongoing subsidies.

Advantages

The primary advantage of an acquisition approach is the relative cost-effectiveness of the properties, compared with new construction.

Because the properties already exist, purchasers do not have to contend with NIMBY-type challenges.

Acquisition permits the retention of an existing mix of market tenants while slowly introducing lower-income tenants as units become available. Acquisition with existing tenants remaining can effectively facilitate a mixing of income without added cost (since market rents cover break-even rent).

Homeownership and scattered rental portfolios offer options to access existing rehabilitation programs to upgrade dwellings.

Weaknesses

Many providers in the non-profit sector appear to be reluctant to pursue acquisition. Most prefer new construction, as they are concerned with adding to the supply.

The acquisition option is limited by the availability of properties offered for sale on the market and requires careful selection and assessment of potential properties.

The option is better suited for market downturns. The window for an acquisition approach in many cities may already have passed, as the current rental market is under high pressure from low vacancies and rising rents (which tend to raise the value of existing properties for sale).

Demand Measures

While supply approaches can play an important role in moderating the market pressures that exacerbate affordability problems, supply initiatives cannot be implemented on a sufficient scale to tackle the large back-

log of these problems. Some form of rental assistance is necessary to address the affordability gap.

Rent supplements

A rent supplement involves an agreement between a public funding agency and a landlord, in which the landlord agrees to enter into a contract to provide rental units for low-income tenants on specified terms. Usually, the tenant's out-of-pocket rent will be based on a rent-geared-to-income basis. The contract will make up the difference between the tenant-paid RGI rent and the actual market rent on the units. During the term of the agreement, there may be an inflationary index to allow the market rent to increase annually, increasing the landlord's rental income but leaving the tenant protected at the RGI rent. As assisted tenants leave, during the term of the agreement, the funding agency has the right to place a new low-income tenant in the unit.

Rent supplements depend on securing the interest of private landlords. However, there is a poor history of rent supplement success in most provinces, despite efforts to advertise for landlords who will participate. Even for properties for which rent supplements have been negotiated, many landlords have elected not to renew these contracts when they expire. Initial terms for agreements in the 1970s were generally for 15 years with renewals now usually on a 3- to 5-year term.

In cities with low vacancy levels, landlords generally can fill their buildings with private market tenants, without the difficulties related to having their tenants selected by a third party. In addition, administrative requirements associated with this approach generally are seen by landlords as a deterrent.

Thus there may not be significant opportunities to use rent supplements to help low-income tenants living in privately operated rental housing. However, there has been a long tradition of stacking rent supplements on non-profit projects.

A number of existing older non-profit projects are not RGI-based, but include units with rents slightly below market levels. This approach is facilitated either by a capital grant or a favourable mortgage rate that helps to lower the break-even rent below market levels. Allocating rent supplements to these units to allow RGI assistance to tenants with very low incomes could provide a low-cost rent supplement option; over time, break-even rents will not rise as quickly as market rents.[9]

A further option is to use a rent supplement program in conjunction with non-profit acquisition of existing properties.

Advantages

This option addresses affordability problems.

A rent supplement agreement is specific to contracted units, so their condition and quality can be verified.

It can be used with non-profit supply but focuses only on the affordability issue (separate from supply).

Over the long run, it is more cost-effective to stack rent supplements on non-profit housing, as the annual rate of increase in non-profit break-even costs has been found to inflate more slowly than market rents.

Weaknesses

A rent supplement does not address the lack of supply.

The option depends on a willing landlord and available units – but few landlords are interested.

Lack of renewal at term can result in difficulty for existing tenants.

Historically, there has been low landlord take-up of rent supplements due to administrative burden and to restricting use and rent on the contracted units.

Shelter allowance

Unlike a rent supplement in which the landlord is implicated in a formal agreement, shelter allowances are direct payments to the tenant and therefore overcome the necessity of negotiating agreements with landlords.

A feature of shelter allowances, as opposed to rent supplements and social housing supply programs (in which the number of units is limited by the size of the existing stock and any new production), is that all tenants who are in need and eligible for assistance potentially can receive it. There are no waiting lists (and unmet need) with shelter allowances. This option also implies a potential expansion of beneficiaries and higher levels of total expenditure.

With a shelter allowance, the assistance takes into account both income and market rent for the unit.[10] Maximum levels of assistance (i.e., a maximum rent level) can limit overconsumption (i.e., the risk that a household will choose a unit that is larger and more costly than necessary) and also are used to constrain program benefits and manage the overall budget.

The structure of the assistance formula is the primary means of public cost control. By encouraging tenants to select units with low market rents, costs are minimized for both the government and the tenant. By contrast, rent supplements and social housing reduce the tenant's rent to 30 percent of income, regardless of the quality of the unit occupied or the associated market rent. One very low-income household may live in a 40-year-old apartment while a similar household may receive a new townhouse.

An immediate concern is the scope and cost of the program. As many as 1.5 million households might be eligible for supplements. A number of approaches are available to manage this problem.

Since social assistance already includes a shelter allowance, it is practical to separate welfare recipients in this analysis. The options for welfare households are either to reform the existing shelter benefits within welfare (which are already conditionally linked to actual shelter costs up to a maximum) or to limit social assistance to income support and address shelter needs under a separate but linked shelter assistance program.

A costing analysis of a shelter allowance initiative undertaken for the Federation of Canadian Municipalities' National Affordable Housing Strategy estimated the cost of an incremental shelter allowance program, assisting 40,000 households annually. The first-year cost for 40,000 households was determined to be between $30 and $60 million. To address the needs of 400,000 working poor households would therefore cost in the region of $300 to $600 million annually. Adding the 240,000 seniors to this estimate would raise costs to between $500 and $950 million annually.

The wide range of the estimate reflects two different benefit formulas. The lower-cost estimate reflects a program targeted only to households paying more than 50 percent of income on shelter with benefits geared to lower this rent burden to roughly 37 percent of income. The more expensive option reflects a benefit formula that lowers household shelter costs to 30 percent of income, equivalent to the assistance levels in social housing.

The actual costs of a shelter allowance program could be reduced by restricting potential client groups (e.g., welfare recipients), phasing in the benefits, or setting lower benefit levels. Initially, eligibility criteria could be relatively restrictive and benefits could be established at minimum levels to address very high shelter cost. Gradually, the criteria could be relaxed and benefits enhanced to levels that allow tenants to obtain adequate accommodation at a maximum of 30 percent of

income, while still ensuring that public program costs are managed and contained.

Although shelter allowances typically are seen as entitlement programs, it is possible to limit enrolment. For example, the approach used in the United States involves using certificates or vouchers, which are limited in number. Like non-profit housing, there would be a waiting list. Households must reapply annually to confirm their continued eligibility. When households served by vouchers are no longer eligible (due to improvements in income or success in finding lower cost housing), the voucher can be reallocated to a household on the waiting list.

Advantages

The option directly addresses the affordability issue and helps to ease very high shelter burdens.

The allowance can be broad-based or rationed.

The benefit formula allows the mechanism to be targeted and to provide varying levels of assistance to differing target groups and households facing more severe affordability problems.

Used in combination with non-profit supply, a shelter allowance reduces the challenge for new non-profit supply, as it is necessary only to get break-even rents down to market levels.

Weaknesses

The option does not address low levels of supply, and subsidy costs are affected by rising rents (caused by low supply relative to demand).

It does not create a long-term asset.

The allowance may be perceived by poverty advocates as a benefit to landlords by subsidizing private sector rents, with no long-term retention of units.

Reform of welfare shelter benefits – A transitional shelter allowance

Almost half of core need households and those facing high shelter-income ratios are social assistance recipients. The shelter component of welfare is not objectively related to actual rental costs and is not indexed to the cost of living. During the first half of the 1990s, this fact was not a problem. But with steep rent increases in a number of centres in the later

1990s, the calculation of the shelter component became an increasingly serious issue.

There is a need to realign intended shelter assistance benefit levels with true shelter costs, and to index benefits to actual market rents (e.g., the median or 40th percentile).

In addition to addressing the inadequacy of current welfare rental assistance levels, it would be effective to link revised benefit levels to ongoing welfare policies that seek to encourage and facilitate the transition from welfare to work.

A shelter allowance for the working poor could be adapted to create a transitional benefit for welfare households. While most provinces and territories have implemented reforms to help social assistance recipients acquire employment skills and work experience, these approaches have not recognized the critical role that stable and affordable housing can play in this process. Other than existing social housing (with a finite stock and long waiting lists), no transitional mechanisms enable households to move off social assistance, accept low-wage work, and still be able to pay the rent.

Welfare households considering work are discouraged, because as soon as they leave welfare, they lose their shelter benefit. Since shelter costs account for such a large part of the household budget, welfare reforms without ongoing housing assistance are ineffective. A shelter allowance, separate from welfare, can be a valuable complement to other initiatives to enable households to move back into the labour force.

Providing ongoing support to assist with the rent provides greater stability for low-income parents with children, helping avoid the arrears and evictions that often cause families to move frequently and disrupt children's development and schooling.

In the case of families with children, a modest shelter allowance in combination with minimum wage work and the new Canada Child Tax Benefit can leave a household with more income than it would receive on welfare, at a cost to government significantly lower than the cost of full welfare benefits.

Typically, shelter allowances are designed to provide relief from excessive rental costs while offering an incentive for the household to economize, limiting program costs. This is achieved by a formula that covers part of the gap between a specified percentage of income and actual rent, up to a rent maximum.

The precise formula can be adjusted to ensure that the recipient does not pay more than a specified percentage of income for rent. The for-

mula can be varied by household size and composition, since larger households have higher food budgets and pay higher rent for larger units. A shelter subsidy of roughly $150 to $250 a month, depending on the market, effectively can reduce a rent burden of 55 percent to a more reasonable proportion of income (30 to 35 percent).

When a person leaves welfare to return to work, such an allowance, costing government less than $3,000 a year, would leave households in a better financial position than welfare benefits that may cost government more than $12,000 to $15,000 a year. The shelter assistance would be phased out as earned income improves. The phase-out can be gradual to avoid the tax-back disincentives that often undermine assistance programs when participants seek to earn an income.

Advantages

A transitional and separate shelter allowance for social assistance recipients could ensure that they are less at risk of losing their housing when moving off welfare into work.

Such a mechanism would support other work incentive policies.

The costs of this transitional initiative would be significantly lower than ongoing full welfare benefits.

The shelter allowance formula is based on actual rent and earned income and benefits reduce as income increases. The slope of the reduction can be controlled through the formula design.

Weaknesses

Over time, more households may remain on assistance and costs could expand – unlike welfare, which tends to be intermittent and transitional.

Implementing this approach requires a significant commitment to welfare reform.

Toward a Comprehensive Housing Strategy

None of the identified options is sufficient on its own to address the full array of housing issues. The nature and magnitude of housing problems vary geographically and depend on local market conditions.

That said, most problems relate to affordability – households spending too large a proportion of an already inadequate income for shelter, leaving little for other necessities.[11] Even households not experiencing

an affordability problem face the indirect consequences of an insufficient number of lower-rent units, since some make a trade-off between price and quality, sharing a dwelling with another family (overcrowding) or accepting poor conditions (inadequate housing). Lowering the cost of producing housing is not a realistic option; much effort has been expended on this approach and most feasible options have been tried – except for reducing the various taxes fees and levies imposed by all levels of government. The greatest potential lies in approaches aimed at increasing ability to pay.

Improving households' ability to cover shelter costs would be the fastest and most desirable way to reduce their shelter cost burden. This can be addressed through a conditional income transfer, linked to actual housing costs – such as a rent supplement or a shelter allowance or simply through additional income. Increasing household income, either through supplements or through increased earning capacity (e.g., higher minimum wages, employment training) would also reduce high shelter-to-income ratios and leave more income for other necessities.

This conclusion suggests that income-based options outside the traditional housing policy toolbox merit serious examination. Tax credits or other means of improving income with some conditional link to housing consumption must be explored. The best option is likely the reform of the shelter component of welfare, since this subpopulation is highly overrepresented among households in core housing need.

Although affordability problems predominate, tackling the demand side of the equation alone would not address the lack of new supply that is the cause of rising rents and worsening affordability and that lead to cost inflation in a demand-side subsidy. Nor would demand measures alone curb the ongoing erosion of the existing limited affordable housing stock outside social housing or improve access for those stereotyped as "less desirable tenants."

To control for inflating rents in an undersupplied market, some form of supply response to support new construction is a necessary complement to any demand-side initiative. Any form of new construction will help ease upward pressure on rents, so measures to stimulate private rental development can play an important role.

By the same token, an exclusive non-profit supply option would be equally inadequate, mainly as it costs more to address two problems (supply and affordability) within the same solution and because a very large-scale production program would be required to meet current need.

It would be impractical to tackle the level of outstanding housing need (more than 1 million households) entirely through a new supply program. However, as population and the number of households grows, new supply is required to meet new need – much of which derives from lower-income households with limited effective demand.

If new supply were to be subsidized, non-profit supply would probably generate better public investment in creating a lasting asset and addressing issues of access than subsidies directed to private development. At the same time, impediments to private rental development, particularly the tax treatment of rental investment income, need to be identified and remedied if the necessary volume of new rental production is to be achieved.

The issue of relative cost-effectiveness is a highly contentious one and is not examined in detail here. However, any assessment of policy options should consider this aspect.[12]

The gradual disappearance of lower-priced, relatively affordable existing rental stock is perhaps the most serious issue contributing to affordability problems. Measures to mitigate this phenomenon are critical. Combining the longer-term benefits of non-profit ownership (less inflationary pressure on rents and long-term preservation of affordable units) with the inherent lower cost of buying existing rental properties through an active program to support non-profit acquisition of existing rental properties may be the more effective way to expand the affordable stock. The advantage of the non-profit sector is not its ability to build new affordable housing, but its ongoing ownership and management of assets. The long-term objective is to maximize affordability rather than return on investment.

While an acquisition strategy can help preserve the existing stock of affordable housing, other measures are required to enhance the ability of renters to meet their rental costs and to broadly stimulate new supply.

The key point is that demand and supply measures are not substitutes for each other – although each is preferred and promoted by particular interest groups for differing reasons. They are complementary measures that, when combined in a well considered comprehensive strategy, can help tackle the persisting affordable housing problem.

In responding to the current crisis of low rental vacancy rates, the federal and provincial/territorial housing ministers and their officials must look beyond short-term, small-scale construction programs. In particular, the prevailing nature of the affordability problem – inadequate income and ineffective income assistance benefits – must be addressed as

part of the solution. This implies the need for a broader dialogue including ministries responsible for income assistance.

The complete paper by Steve Pomeroy, "Toward a Comprehensive Affordable Housing Strategy for Canada," was published by the Caledon Institute in October 2001. See www.caledoninst.org/Abstracts/894598946.htm.

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Endnotes

1 For example, a lone parent with two children of the same gender aged 5 and 8 would require a two-bedroom unit. If the median monthly rent of a two-bedroom apartment is $640, the income required to afford this unit is $25,600 ($640 × 12 months/ .30). Similar households with an income above this level would not be in core need.

2 Statistics Canada, *The Daily*, Cat. No. 11-001E, Ottawa.

3 Another reason for the apparent decline is a shift in Statistics Canada survey methodology. Both the census and former HIFE datafiles used current year rent compared to previous year income. The SHS collects data on income and rent for the same period. So comparison across the two data sources may be inappropriate.

4 Federal funding for new non-profit housing ended effective December 31, 1993, and since programs were cost-shared with provinces and territories, almost all new social housing development ceased. Ontario maintained a unilateral program until 1995. Only B.C. and Quebec still have modest social housing programs (the Quebec programs are more focused on acquisition and rehabilitation than on new construction).

5 One of the critical risks for potential investors is the regulation of the rental sector. While rent regulation has been relaxed in a number of provinces, investors still fear

reintroduction. It is not rent controls themselves that scare investors away, but the uncertainty about future regulatory regimes that increases risk.

6 Rent regulation/control has been omitted from this discussion. Rent controls impose specific limits on the level and frequency with which rents can be increased. Proponents of the former controls point to their impact in preserving affordability; opponents (largely landlords) counter that controls are discriminatory and place undue burden of public policy on one specific sector (rental landlords). Rent controls also have been identified as a deterrent to new rental investment – although, arguably, it is the uncertainty associated with a regulatory regime rather than the controls themselves that constitute the deterrent. Overall, opponents argue that rent controls are a blunt policy instrument with undesirable outcomes – the benefits may not reach the intended beneficiaries. In fact, controls benefit many households that do not require assistance. A substantial portion of the low-rent housing stock is occupied by households with incomes that would allow them to pay higher rent, while those most in need continue to face severe affordability problems.

7 The generic term "non-profit housing" is used in this report. This term can also include cooperative housing – a variant that seeks to assist lower-income households and operates on a not-for-profit basis – although the management structure and philosophy are different (encouraging active resident participation).

8 Such options are not necessarily restricted to lower-cost markets, although the viability is obviously greater. An analysis of real estate listings for one month in 1999 in B.C. found more than 1,000 dwellings (including duplex and townhome units) for sale outside the two major cities for less than $90,000 – affordable to working poor households at a payment of less than $600 a month.

9 Previous research has examined the cost trends of private rent supplements over a 20-year period compared with the comparable cost of stacked rent supplements in non-profits and found that, over time, non-profit break-even rents increase at a slower rate than market rents – suggesting a cost benefit to stacking rent supplements on properties under non-profit ownership.

10 For example, a shelter allowance may provide assistance equal to 85 percent of the difference between actual rent and 35 percent of income. So if income is $1,500 and rent is $600/month (40 percent of income), a shelter allowance may provide relief of [$600 – ($1500 × 35 percent)] × .85 percent = ($600 – $525) × .85 = $64. This lowers net rent to $536 or 36 percent of income. This formula can be adjusted so the net effect lowers the shelter to income ratio to 30 percent, equivalent to social housing rents. A maximum rent, say $600, might be imposed to prevent households selecting expensive units – although there is already an incentive to seek a reasonably priced unit, as the household pays a share of the higher rent.

11 "Food insecurity" is defined as a situation in which household members are forced to compromise on the quality of their diet because they have insufficient income to cover necessities. High housing costs may contribute to this phenomenon. See Statistics Canada, "Food Insecurity in Canadian Households." *The Daily,* August 15, 2001.

12 The key tradeoff is between paying a premium for new supply with the benefit of non-profit ownership, a lower rate of subsidy inflation, and long-term availability of the affordable unit, versus low initial costs but inflating subsidy costs in a shelter allowance as market rents inflate into the future. The comparable present value is sensitive to the initial cost gap and assumptions of rent inflation and discount rates.